

7 November 2013 | 8 pages

Consumer Finance  
North America | United States

# Nationstar Mortgage Holdings Inc (NSM)

## Results: First Thoughts on Q3'13

- Citi's Take** — This morning NSM reported its Q3'13 results. Our early take is that these results fall short of our and consensus expectations, particularly sharply reduced earnings guidance. While the mortgage market is challenging, we had hoped that NSM would have held up better given their strong refinancing pipeline (last qtr noted \$45B+ in their portfolio and would still be \$34B+ even if rates moved 100 bps higher). We expect the stock to trade down today on the lower guidance.
- Headline EPS** — NSM reported GAAP EPS of \$0.91, below our \$1.25 estimate and consensus of \$1.26. The miss versus our estimate was largely due to higher operating expenses (\$396M vs. our \$346M estimate and Q2 of \$340M). In terms of revenues, higher servicing revenues (benefitted from a \$96M FV MTM from MSRs) was off-set by weaker mortgage GOS (\$206M vs. our \$287M estimate).
- Guidance** — Reflecting the tough mortgage market, EPS guidance was sharply reduced to \$2.65-\$3.10 from \$4.05-\$4.75 in 2013 and to \$4.50-\$6.00 from \$6.45-\$7.50 in 2014. This represents declines of -35% and -25%, respectively. Mgt noted that given the reduced contribution of the origination business, the servicing segment will now account for 70% of guidance vs. 45% prior.
- Strategic Initiatives** — NSM also announced that they have entered into an agreement to sell its non-core wholesale and distributed retail origination channels to Stonegate Mortgage (SGM; not covered). This will allow NSM to focus on their consumer direct origination channels (recapture, Greenlight, KB Home) and the correspondent channel. Additionally, NSM announced expense actions that will result in headcount reductions of 1,100 employees (including employees expected to join Stonegate. NSM expects \$63M of annualized cost savings.
- Implications** — While today's results are disappointing, it does serve as a reminder of the volatility in the mortgage business. Last night we saw disappointing results from another non-bank mortgage company, PFS (PFSI.N; US\$16.71; 1)I (see [our note](#)).

<b>Neutral</b>	<b>2</b>
Price (06 Nov 13)	US\$49.22
Target price	US\$52.00
Expected share price return	5.6%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>5.6%</b>
Market Cap	US\$4,458M

### Price Performance (RIC: NSM.N, BB: NSM US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2012A	0.67A	0.41A	0.61A	0.71A	2.41A	2.54A
2013E	0.70A	1.37A	1.25E	1.45E	4.77E	4.71E
Previous	0.70A	1.37A	1.25E	1.45E	4.77E	na
2014E	na	na	na	na	6.90E	6.97E
Previous	na	na	na	na	6.90E	na
2015E	na	na	na	na	7.80E	7.52E
Previous	na	na	na	na	7.80E	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Nationstar Mortgage Holdings Inc

### Valuation

Our price target for Nationstar is \$52. This implies a 10.9x multiple on our 2013 estimate of \$4.77 and a 7.5x multiple on our 2014 estimate of \$6.90. Our 2014E multiple is in line with peers trading at 7-9x.

### Risks

**Regulatory/Litigation Risk.** Nationstar operates in an industry that is highly regulated by national and state agencies, including the CFPB. Given its involvement in the mortgage resolution / foreclosure process and mortgage origination business, NSM is exposed to heightened regulatory compliance burdens and may incur increased litigation costs if their actions are challenged.

**Acquisition Risk.** While we expect servicing assets to transfer to non-bank servicers over time, the pace and magnitude of these acquisitions may not live up to our or NSM's forecasts. If MSR acquisitions get delayed or if there is significant competition to acquire these portfolios, earnings and returns would be negatively impacted.

**Mortgage Origination Risk.** Currently, NSM is benefiting from robust mortgage refinancing volumes and wide gain-on-sale spreads. If interest rates were to rise and refinancing activity slowed, NSM's origination volume would be negatively impacted. Further, gain-on-sale spreads are at historic levels, and as origination capacity returns to the market, these spreads are likely to normalize, pressuring gain-on-sale income.

**Prepayment Risk.** If interest rates remain low, or if the government extends HARP into 2014, NSM's servicing portfolio could be adversely affected by heightened prepayments which would lower servicing income. However, we note NSM would benefit from increased origination volume in this scenario.

**Deterioration of the Residential Mortgage Market.** Falling home prices result in higher LTVs and lower recoveries on foreclosure. As LTVs decline, borrowers may be incented to default on their mortgage loan even if they have the ability to make principal and interest payments, which are referred to as strategic defaults. All of the above would increase the overall cost of service and may ultimately reduce the number of mortgages we serve.

If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. Likewise, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

## Appendix A-1

### Analyst Certification

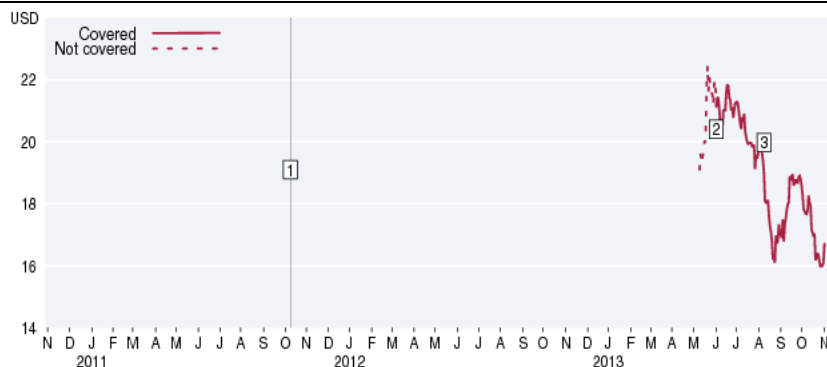
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Analyst: Donald Fandetti, CFA  
Covered since June 3 2013



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	3-Jun-13	*1	*26.00	21.14

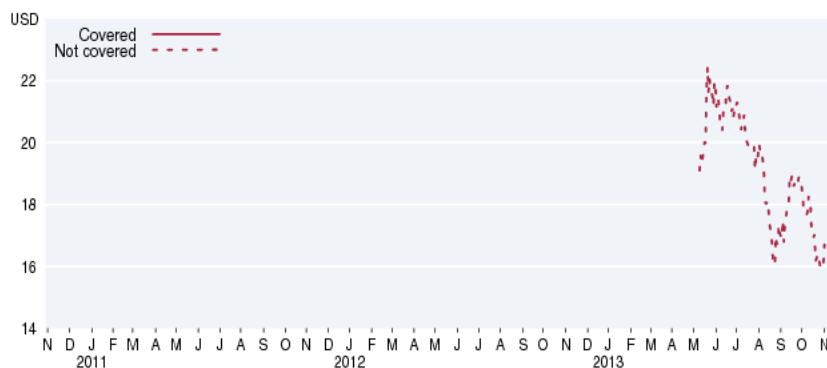
	Date	Rating	Target Price	Closing Price
3	8-Aug-13	1	*22.00	18.99

Rating/target price changes above reflect Eastern Standard Time

### PennyMac Financial Services Inc. (PFSI)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Donald Fandetti, CFA  
Covered since June 3 2013



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### Nationstar Mortgage Holdings Inc (NSM)

#### Ratings and Target Price History Fundamental Research

Analyst: Donald Fandetti, CFA  
Covered since April 23 2012



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	23-Apr-12	*1H	*18.00	14.60
3	5-Jun-12	*2H	*20.00	19.80

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	18-Jun-12	2H	*22.00	18.85
5	14-Aug-12	2H	*30.00	27.60
6	6-Nov-12	2H	*29.00	27.11

	Date	Rating	Target Price	Closing Price
7	7-Jan-13	*2	*40.00	38.83
8	7-May-13	2	*45.00	39.99
9	6-Aug-13	2	*52.00	49.25

Rating/target price changes above reflect Eastern Standard Time

## Nationstar Mortgage Holdings Inc (NSM)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Donald Fandetti, CFA

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55%	50%	43%	64%	51%	48%

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